THE POLITICAL ECONOMY OF PUBLIC ADMINISTRATION

Institutional choice in the public sector

MURRAY J. HORN

The Treasury
New Zealand

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Introduction

Considerable academic and popular criticism is directed at the way public administration is organized and how it functions. Many claim that the public sector lacks the incentives for effective performance and that there is a disturbing lack of accountability to the elected representatives whom administrators are supposed to serve. Given these common perceptions, it is a real puzzle to find that the administrative arrangements that shape administrators' incentives and determine their accountabilities are so common and so persistent. It is even more of a puzzle given that the lack of any neat separation between policy and administration means that administrative decisions influence policy outcomes. If these arrangements are so bad, why do we find them in so many jurisdictions and why have they persisted for so long? This book develops a theory to explain key institutional characteristics of the modern administrative machinery of government. It is part of a growing appreciation of the role of institutions in both political science and economics.

Just as the private sector includes corporations, partnerships, and non-profit organizations, the public sector is made up of different forms of organization, each with its distinctive characteristics. In the regulatory arena, laws can be administered by the courts, independent regulatory commissions, or executive agencies. When it comes to the production of goods and services, legislators typically turn to tax-funded bureaus with personnel policies determined by civil service legislation. Sometimes, however, they use state-owned enterprises (SOEs), which are primarily funded by sales revenues and organized along more commercial lines. All of these different forms of public sector organization have distinctive governance, financing, and employment arrangements.

There is also considerable diversity in the extent to which important decisions are left to be resolved at the administrative level. Even if legislation could be made unambiguous, it is almost impossible to make explicit provision for all possible future contingencies. Although some decisions will inevitably be made by administrators, the degree of legislative vagueness varies and is a matter of legislative choice. This is illustrated by the willingness of legislatures regularly to include specific standards in some types of legislation, like tax legislation, and their occasional willingness to include these standards elsewhere, as the United States Congress did in the Clean Air Act and Equal Employment legislation. Whatever the reason, making legislation vaguer effectively delegates decision-making authority to those who administer the legislation and increases the influence of those private groups best able to sustain an active interest in this administration.

There are important institutional regularities in the distinctive character of specific forms of public sector organization, in the different functions performed in these different organizational forms, and even in the boundary between public and private sectors. This is not to deny that changes can and do take place. In the 1980s, for example, there has been widespread privatization of state enterprises. Despite these changes, however, two important types of institutional regularity are discernible:

i Distinctive governance, financing, and employment characteristics of different organizational forms – like bureaus, SOEs, and regulatory agencies – appear to be remarkably stable in the modern bureaucracy.
ii There are important regularities in the relationship between these different forms of organization and the administrative functions they are asked to perform. When it is possible to sell public sector output, for example, we are more likely to see an organization with the characteristics of an SOE than a tax-financed bureau; that is, an organization that is funded by sales rather than taxes, is governed by a board that enjoys some independence from the legislature, and is less constrained by civil service rules. And when public and private enterprise are compared, there is a remarkable similarity in the industrial concentration of SOEs across sectors in different countries.

This book develops a theory of legislative choice that is capable of explaining these regularities.

Legislators are the center of attention because they determine institutional form. They decide which type of organization will be used in which instance – for example, whether regulation will be administered by the courts, an independent regulatory commission, or an agency of the executive branch. They also determine the form of these institutional alternatives. They specify the participation and decision rights of various parties – for example, how vague legislation will be, how much authority will be delegated to officials, and the administrative procedures that effectively allow private interests to participate directly in the administrative decision-making process. They also influence the financing of administrative activity and, more significantly, the rules governing the employment of administrators. Decisions in these areas will help determine the incentives facing administrators and, therefore, will influence how administrators exercise their discretion. Legislative interest in questions of organizational form is active, detailed, and controversial.

This focus on the legislature is common in the academic literature but does raise questions about the role of the executive. This issue is discussed in Chapter 2, which sets out the assumptions about the role and motivations of legislators. The defining characteristic of legislators is that they are elected, rather than appointed, and have to face reelection. They are assumed to perform both legislative and executive functions, although the legislative role receives considerably more attention. These assumptions simplify the characterization of representative government by focusing on its essential features, which does not deny that the clarity and generality produced by simplification come at a cost. These assumptions are more descriptive of some jurisdictions than others, although when these differences are particularly important they receive specific attention in subsequent chapters. Much more could be done to explore the effect on institutional design of different constitutional arrangements, including the impact of different relationships between the legislature and executive. However, this is much more likely to add to, than detract from, the value of the approach developed in this book.

This book explores the factors that are likely to lead legislators to favor different degrees of delegation to different types of administrative organization in different circumstances. It brings together a number of different strands in the "rational choice" literature in political science and covers many different types of organization within the same framework. It also draws heavily on the "transactions cost" approach used by the economics literature to help explain contractual arrangements in the private sector, including questions of organizational form. Most of the book is concerned with explaining the key distinguishing characteristics of three different forms of public sector organization: the regulatory commission, the tax-financed bureau, and the state-owned enterprise. For example, what role do rules of administrative procedure play in regulatory administration? And how can we explain the distinctive features of the employment arrangements that characterize the modern civil service; the rules governing hiring, firing, pay, and promotion; and the structure of compensation, tenure security, and restrictions on outside competition?

Institutional choices that determine the character of administrative organization are important in part because they influence "who gets what" out of the political process. They determine the extent of decision making at the administrative level; the ability of officials, private interests, and elected representatives to influence these decisions to their own advantage; and the incentives that these different actors face. This is why legislative decisions on administrative questions are often surrounded by controversy.[1] These choices can also influence the scope of political activity because they influence the ability of any coalition of lawmakers to deliver durable benefits to their supporters. If benefits are unlikely to be durable they may not be able to sustain the political effort needed to secure enactment.

The effect of factors like administrative, personnel, and budgetary rules on bureaucratic behavior has received considerable academic attention. Over the past decade there has been considerable emphasis on the ability of incumbent legislators to control their administrative agents. Although there are many useful insights in this literature, the evidence favoring legislative control is ambiguous. This emphasis is also hard to reconcile with common legislative impediments that constrain the incumbent legislature. Civil service legislation, for example, specifically limits legislative influence over hiring and firing, and in some countries this protection extends all the way to bureau heads.

These impediments are a lot easier to explain if the basic analysis is extended by placing the enacting legislature at center stage, rather than the incumbent legislature. The enacting legislature has an incentive to protect the benefits it delivers to its constituents from subsequent legislatures, as well as administrators. It makes institutional choices that determine administrative structure and process, which, in turn, affect the ability and willingness of future legislators – as well as administrators and private interest groups – to influence administration to further their own ends. Institutional features like mandated expenditure and civil service employment protection make it much more difficult for subsequent governments with different policy preferences to influence administrative decisions.

Besides its importance to government, institutional choice in the administrative area presents us with the puzzle described in the opening paragraph. Despite regular challenge, the basic institutional characteristics of the public sector are common and persistent. Part of the answer is that these organizations probably perform better than their critics would have us believe.[2] There is also bound to be some dissatisfaction reflected from the more basic conflict in society about exactly what it is that these organizations should be doing and for whom. We are reminded by Wilson (1967) that there is often an inherent conflict among the objectives that bureaucracy is asked to pursue. It may, for example, be impossible to be "neutral" or "impartial" in the sense that people who meet some very general criteria are treated the same way, and still be "responsive" to special needs.

There is also a growing awareness that these public institutional arrangements persist because they serve the interests of the legislative coalitions that use them. They represent at least part of the solution to the problems facing governments. This suggests that the key to explaining these institutional arrangements is in understanding the nature of the problem that they are intended to solve. There are generic problems that face all legislators if, as is assumed here, they are motivated by their own policy preferences and a desire to retain power. The framework developed in this book integrates factors already identified in the literature as important – like decision-making and agency costs – with other factors that are likely to pose problems, like the costs of uncertainty and commitment. Because legislatures are sovereign, it is particularly difficult for the enacting legislature to commit subsequent legislatures to maintaining a certain course of action. This threatens the durability of legislative benefits and, therefore, reduces the value of legislation. This "commitment problem" is likely to loom particularly large in the political arena.

This book is concerned with explaining what we see. It does not draw normative conclusions or suggest areas for reform. It should, however, make it easier to predict the consequences of organizational change and thus to assess reform proposals. Legislators will reconsider institutional arrangements when the problems they face change with changing circumstances. Moreover, the fact that the administrative structures and processes examined here have persisted does not imply that there is no room for improvement. Even if observed institutional regularities are the best administrative solution to the political problems faced by legislators, this does not mean that they will necessarily be the collectively most desirable.[3] Lasting reform, however, may be difficult to achieve without accounting for, and perhaps modifying, the political calculus that sustains the existing arrangements.

The book is organized as follows. Chapter 2 presents the transactions cost approach that is applied in the rest of the book. It describes how this approach is used to explain the institutional choices that enacting legislatures make. Chapter 3 applies this approach to institutional choice in the regulatory arena in the United States. It examines choices made about the scope of authority delegated to the administrative level, the choice of regulatory agent, the procedures imposed on administrative decision making, and the ease with which subsequent legislatures can influence administration through oversight, budgets, appointments, and direction.

Chapters 4 and 5 apply the transactions cost approach to explain the institutional choices the enacting legislature makes when it turns to tax-financed bureaus to produce goods and services and redistribute income. These chapters focus on features of bureau organization that are common across the developed world. Chapter 4 explains two common features of the budget: the large amount of expenditure that is mandated by the enacting legislature and the type of financial controls that the legislature imposes on bureaus. It examines the proposition that budgets can be used by the legislature to help control bureaucratic behavior and concludes that they have very little value as a coercive device. That focuses attention on the role that civil service rules play in controlling both commitment and agency costs, which is examined in Chapter 5. That chapter examines the decline of patronage and the emergence of the merit-based civil service. It also explains how the common features of the civil service can act to reduce agency problems: merit appointment, promotion within and between grades, and the pension and tenure arrangements that are common to public sector bureaus.

Chapters 6 and 7 apply the transactions cost approach to explain the institutional choices the enacting legislature makes when the production of goods and services can be largely funded from sales revenues. These chapters discuss the experience with state-owned enterprises in the developing as well as the developed world. Chapter 6 uses the approach developed here to examine the boundary between public and private enterprise. It explains why SOEs tend to be concentrated in the same sectors – like postal services, railways, telecommunications, electricity, and gas – across many different countries. Chapter 7 examines the choice between public enterprise and the tax-financed bureau.

Chapter 8 draws out some of the more important conclusions from previous chapters. It also illustrates how the analytical framework developed here might be used to address policy issues.